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Practical Guide to Major Changes Now Under Discussion in the Nonprofit Sector

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> "...those who turn a blind eye to the problems in the charitable sector, or seek only a fig leaf of reform, potentially cause real long-term damage to nonprofits."
>
> - Senator Charles Grassley
> Chair, Senate Finance Committee
> April 5, 2005

> "...the vast majority of America's 1.3 million charitable organizations are now, and have always been, responsible, ethical and accountable..."
>
> - Diana Aviv, President, Independent Sector
> April 5, 2005

INTRODUCTION

Major changes are now being proposed for governance and oversight of the charitable sector on the national level. If enacted, those changes will impact every New Hampshire charitable entity in significant ways. This article addresses the proposed changes, which include, among others, mandatory financial audits for larger charitable entities, mandatory certification of the Form 990 by senior executive officers of charitable entities, increased penalties on foundation managers engaged in self-dealing, and prohibitions of certain transactions of donor-advised funds.

This article is intended to alert New Hampshire attorneys who provide legal advice to charitable entities, to inform New Hampshire accounting firms that prepare audited financials statements for charitable organizations, and to educate New Hampshire citizens that serve on nonprofit governing boards. It should also be of use to New Hampshire citizens who seek reassurance on the integrity of the charitable sector.

This article draws from a variety of sources: (i) the testimony before the Senate Finance Committee on April 5, 2005;[2] (ii) the Interim Report (the "Report") that was prepared by the Panel on Nonprofits (the "Nonprofit Panel");[3] (iii) the work of the New Hampshire "Excellence in Governance Project;"[4] (iv) the discussions held at the New York University School of Law, led by Professor Harvey Dale;[5] and (v) the commentary by advocates within the charitable sector, including the National Center for Responsive Philanthropy (NCRP).

There are many divergent voices with profoundly differing perspectives on how the nonprofit sector should be regulated, on what specific reforms are needed to curb the documented abuses, and how to achieve good governance. There is, however, no consensus. On April 5, 2005, divergent visions and different roadmaps were placed before Senator Charles Grassley's Finance Committee. As a result of the Finance Committee's hearings in 2004 and 2005, there has been more intense discussion of "good governance" and "accountability" in the past 10 months than was seen in the prior 10 years, with unique and interesting suggestions being offered.[6] The Senate Finance Committee is expected to propose legislation later this year.

The purpose of this article is not to endorse any of the specific reforms being considered, but rather to present a brief snapshot of what the differing roadmaps and recommendations are at this mid-point in the national discussion. A second article will appear later to describe the final resolution, if indeed there is finality or consensus on these issues. Because this article is brief, interested readers are urged to access the full testimony, reports and commentary referenced in this article for a more complete picture.

I. THE PANEL ON THE NONPROFIT SECTOR

The Panel on Nonprofits (the "Panel") was organized in 2004 to propose recommendations for changes in the charitable sector to the U.S. Senate Finance Committee, which had held Committee hearings and had begun scrutiny of the sector. The Panel is composed of 24 leaders in the charitable sector and was supported by a coalition of some 500 charities and foundations.[9]

The Panel solicited suggestions from organizations throughout the United States,[10] posted its Interim Report on the internet and presented its findings to the Senate Finance Committee Chair Charles Grassley on March 1, 2005.[11] The Panel should be congratulated on its willingness to wrestle with such complex issues in such a compressed period of time; and Diana Aviv, the President of Independent Sector, deserves special note for the energy and skills that she brought to the task.[12]

The Report is a two-sided coin. It contains recommendations that charities should *voluntarily* adopt to improve governance and recommendations for *legislation* that would, among other things, increase funding of the IRS. The Panel's goal is to ensure continued public trust in the sector. The Report contains approximately 24 recommendations; and a Final Report will deal with the most difficult issues.[13]

At the April 5th hearing, the Senate Finance Committee heard testimony on many issues, including abuses involving tax-exempt organizations. According to estimates, abuses in the nonprofit sector cost the U.S. Treasury some $15 billion per year in losses;[14] and that is of great interest to both the Senate Finance Committee and the Joint Committee on Taxation.[15] The website for the U.S. Senate Finance Committee addresses the tax consequences of charitable abuses, with statements by Senators Grassley (R-Iowa) and Baucus (D-Montana).[16]

It was neither Federal nor State regulators that crafted the proposed changes found in the Report.[17] On the contrary, it is leaders of the charitable sector who crafted the recommendations.[18] The fact that nonprofit organizations themselves have taken the lead of this "reform" movement is important. Leaders of the charitable sector are attempting to offer a coherent plan with specific ideas to increase transparency, improve governance, and strengthen government oversight.[19] In doing so, the Panel tried to strike the right balance "between a self-regulatory system for charitable organizations…and vigorous governmental oversight and enforcement."[20]

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A. Voluntary Steps

The Report encourages charities to adopt *voluntarily* the following recommendations. First, all charities *should* adopt conflicts of interest policies. (In 1997, the New Hampshire Legislature required that all charities adopt such policies.[21] See **Attachments A and B** to this article.) Second, all charities *should* make certain that individuals with financial literacy skills are included on their governing boards. (In 1997, the New Hampshire Legislature required "diversity" on all nonprofit boards.[22]) Third, all charities *should* adopt policies and procedures to "encourage and protect whistleblowers." This last recommendation addresses the need to reassure staff members that there will not be retaliation against them for alerting senior officials in a charity to suspicions of wrongdoing within the organization.

B. Enforcement Steps

The Report recommends stronger disclosure rules and greater funding for the IRS. First, there is a recommendation that the chief executive officer of the charity (or a senior official) be required to certify that the Form 990 report is correct and complete. Second, there is a recommendation that electronic filing of the Form 990 be made mandatory.[23] Third, there is a requirement that all charities with revenue in excess of $2,000,000 have an independent audit conducted annually. (In New Hampshire, the Legislature required such independent audits for all charities with income in excess of $1,000,000, effective in 2004.[24]) Fourth, the Panel recommends that a charity's tax-exempt status be suspended if that charity fails to file its Form 990 with the IRS for two or more consecutive years (after notice from the IRS).

Impetus for Reform: The Cabot Charitable Trust

The front-page revelations about the Cabot Trust in Massachusetts served as a wake-up call for reform.[7] Paul C. Cabot, Jr., a trustee, had taken excessive compensation from the Paul and Virginia Cabot Charitable Trust to make payments on homes in Florida and Massachusetts, on yacht club fees and golf club fees, and to pay for a lavish wedding (estimated cost: $200,000) for his daughter.[8] Although the Cabot Trust distributed *less than* $500,000 in charitable grants in 2001, Paul C. Cabot's trustee fees were $1,000,000 in 2000. In 2001, his fees were *increased* to $1.4 million. During a nine-year period, Paul Cabot took approximately $7.5 million in trustee fees from the Trust.

Jamie Katz, the Director of Charitable Trusts in Massachusetts, took enforcement action, forcing Cabot to disgorge approximately $4,000,000 in fees paid to him by the Trust. In addition to restitution, Cabot is also prohibited for life from playing any role with any Massachusetts charity. Since IRS regulations prohibit excessive compensation, Cabot may face additional scrutiny and penalties on the federal level.

C. Detailed Provisions

1. Stronger Penalties. The Panel recommends stronger enforcement where financial matters are concerned. These include recommendations (i) to "fully enforce existing financial penalties" for failure to file accurate returns and (ii) to "extend penalties imposed on preparers of personal and corporate tax returns for omissions or misrepresentations of information" on the forms filed by charitable entities. The Panel also advocates increasing the tax penalties on managers of foundations and others who knowingly participate in self-dealing transactions.

2. Donor-Advised Funds. The Report spends considerable time on donor-advised funds and the alleged abuses in that sub-sector. There are strong recommendations regarding donor-advised funds (funds that are controlled by a public charity but where the donor retains the right to make recommendations on the distribution or the investment of these funds). There is concern over situations where donors become recipients of compensation from the fund or where the fund makes donations to a donor-related entity.

3. Additional Funding of the IRS. The Panel notes that resources available at the IRS for monitoring the charitable sector are inadequate, a fact others have noted repeatedly, including the Government Accounting Office (GAO).[25] The underlying problem is that, while the IRS staff has remained constant, there has been a dramatic proliferation of charities and a formidable growth in the assets held by charities. The Report recommends increasing the resources of the IRS for oversight and enforcement activities.

D. The Final Report.

The Panel is expected to issue its Final Report in June. In that report, the Panel will wrestle with broader questions, including what is the appropriate size and structure of a charitable governing board. The Panel will address "excessive" travel costs – e.g., lavish hotels and first-class air travel – and will consider limitations on levels of spending, either in the form of legislation or as "best practices." The retention of compensation consultants is also an issue that the Panel will address

The Panel is also considering investment decisions made by charitable entities and the wisdom of adopting "prudent investor rules." (In New Hampshire, the Legislature adopted the prudent investor rule in 1999 for New Hampshire charities.[26]) Discussions on other questions include whether Federal laws are needed to deal with conversions of nonprofit organizations such as nonprofit hospitals and nonprofit Blue Cross Blue Shield Plans. (New Hampshire adopted a conversion statute dealing with nonprofit hospitals and nonprofit Blue Cross in 1999.)

There is, in short, a determination to examine all of the issues that affect "good governance" and "accountability" in the charitable sector – and to complete the work quickly and efficiently. Building consensus on these critical issues will not be easy; and the efforts that the Nonprofit Panel is making deserve thoughtful consideration.

E. Commentary on the Interim Report

The Interim Report has brought a wide variety of responses.[27] Approximately 200 charitable entities have thus far endorsed the Report – a clear indication of support for its initial findings. However, a number of commentaries by informed individuals point to the Report's shortcomings.[28] The Panel is now crafting additional recommendations; and both the Initial Report and the Final Report should be considered together. The Panel also intends to publish model codes of ethics and model conflicts of interest policies. (In New Hampshire, the Attorney General's Office published model conflicts of interest policies in 1997 and circulates them in its "Guidebook for Nonprofit Directors" available on its website.[29])

(a) National Center for Responsive Philanthropy. Rick Cohen, the executive director of the National Center for Responsive Philanthropy (NCRP) offered critical comments:

> "Despite having raised more than $3 million to support their work, a panel of nonprofit leaders has generated paltry and picayune accountability recommendations that will accomplish little or nothing to cure the accountability problems facing the nonprofit sector."

The NCRP has been a philanthropic "watchdog" for some 30 years; and the NCRP offered its own recommendations. Its roadmap also deserves thoughtful consideration.

The NCRP recommendations are set out in full at the NCRP webpage and include, among others, the following: (i) the need for an annual "payout" by private foundations of more than the current five percent of assets and the need to have administrative expenses excluded from the five percent pay-out calculation; (ii) the disclosure of all insider relationships in foundations involving trustees, nonprofit executives and vendors that provide professional services to the trust (investment, legal, accounting); (iii) a reduction of the level of compensation (other than travel and accommodations) for trustees and board members to $8,000 per year; and (iv) an increase in the budgets of the tax-exempt section of both the IRS and the state attorneys general in order to bolster their oversight and enforcement functions. In addition, the NCRP offered a critique of the Nonprofit Panel's recommendations, to be found at the NCRP website.

(b) Pablo Eisenberg. Pablo Eisenberg is a major independent voice in the sector, with a distinguished career at the Georgetown University Public Policy Institute. Eisenberg's comments were published in the "Chronicle of Philanthropy" and stated that the working group had "produced a timid, uninspired report…very short on tough measures needed to stop abuses and restore public confidence."[30] The full text of Eisenberg's commentary – and his own recommendations – are found in his article in the Chronicle.

II. THE ATTORNEY GENERAL, THE IRS COMMISSIONER AND THE JOINT COMMITTEE

The April 5th Senate hearings revealed the depth of the differences on these issues. Three government officials presented a different view of the nonprofit sector and the harm that certain behaviors have caused. Their testimony also contained specific reforms for changing the sector. The three individuals were Attorney General Mike Hatch (Minnesota), Internal Revenue Commissioner Mark W. Everson, and George K. Yin, Chief of Staff for the Joint Committee on Taxation.

A. Mike Hatch (Minnesota AG)

The recommendations by Attorney General Hatch were specific and were drawn from his investigations of several health care systems in Minnesota, specifically the Allina investigation and the Fairview Health Services investigation.[31] Attorney General Hatch's perspective is contained in his statement that "self-regulation is no replacement for strong government regulation" of the charitable sector. He noted that self-regulation alone is not the answer because governing boards "often actively participate in the abuses" and governing boards often "take a subordinate role to the paid executives," thus allowing the tail to wag the dog.[32]

Attorney General Hatch recommended a series of reforms, including the elimination of the rebuttable presumption for the reasonableness of compensation that the IRS permits, if governing boards follow the processes required by the IRS.[33] General Hatch also recommended that expenses for CEOs and staff of charitable entities be limited to the expenses permitted to federal employees, that the CEO certify to the accuracy and completeness of the Form 990, and that independent auditors be replaced on a regular basis. His testimony was succinct and the remarks may be viewed in full at the Senate webpage.

B. George C. Yin: Joint Committee on Taxation

George C. Yin spoke for the Joint Committee on Taxation and focused on a variety of abuses in the tax-exempt sector, including (i) the automobile donation programs where taxpayers donated used cars to charity and took full fair market value on their tax returns, and (ii) the donation and valuation of stock of closely held corporations, art work, and household furniture, for which tax payers took large charitable deductions.

The Joint Committee also recommended the elimination of the presumption of reasonableness (safe harbors) on executive compensation under the IRS regulations. Mr. Yin's focus was on the billions in dollars lost through charitable abuses annually. He also recommended that the IRS require charities to submit information every five years, allowing the IRS to determine whether the charity still fulfills its charitable mission. Finally, he made recommendations on the conversions of nonprofit hospitals and tax shelters.

The Minnesota Attorney General's Perspective:

AG Mike Hatch's testimony on April 5 , 2005 included the following remarks on Allina, a nonprofit health system in Minnesota:

"Allina paid for employee travel to destinations such as Aruba, London, Paris, Venice, Grand Canyon, Athens, Cancun, Pago Pago, and Los Cabos…It paid for over 30 trips to the Hawaiian Islands…"

"Allina paid $89,000 for its board members and executives, and their spouses, to travel to the Phoenician Inn in Arizona. The Phoenician Inn boasts a $25 million art collection, marble from the same Italian quarry that Michelangelo used for the Pieta, chocolate for "tuck-in" service flown in from Belgium three times a week…Executives charged the organization for $100 floral arrangements to decorate their $855 per night suites. When we asked Allina to explain its "business purpose" for the trip, it stated that the trip was designed to inspire discussions about "health care reform."

"Allina sent executives to Monterey, California, where they traveled in limousines and expensed thousands of dollars in meals in the area's most exclusive restaurant. Allina stated that the trip was designed to teach executives how to run a health care system with a "moral center…"

"Allina paid for private memberships for ten of its top executives…It reimbursed one executive $1,400 to analyze his handicap, polish his golf clubs, and otherwise tend to similar needs…Executives were reimbursed for lavish gifts to other executives and board members, including $3,000 bronze sculptures, $1,300 golf clubs, and $600 Waterford crystal."

"Allina manipulated its bonus plans to guarantee that executives would qualify for bonuses…"

"Allina's "independent" auditor was paid over $35 million, mostly for acting as a consultant. No detail was provided to justify the accounting firm's professional fees, nor was supporting detail provided for over $4 million in expenses. The auditor repeatedly issued unqualified audits. The organization was rife with conflicts of interest. The Allina board of directors not only failed to prevent abuses, but actively participated in them."

C. Mark Everson, the IRS Commissioner

The testimony of IRS Commissioner Mark Everson on April 5th and his letter to Senator Grassley on March 30th are among the most important of the documents submitted to the Finance Committee. His comments reflect first on what has gone wrong in the sector and then puts forward a set of specific recommendations.

The Commissioner noted the "corrosive impact" of the abuses in the charitable sector upon public trust in nonprofit organizations. His comments on a "culture that has become more casual about compliance and less resistant to non-compliance" set the tone for his specific recommendations. His admission that the IRS "enforcement presence faded in the late 1990's" because of the decline in staff personnel and the growth of the nonprofit sector are factors upon which all can agree.[34] His comments that some governing boards have been lax and have "not been immune" from bad corporate practices is also sobering. Indeed, independent scholars echoed the same themes over a decade ago, noting in 1993 that "the cry for enhanced means of enforcement has intensified."[35]

The sheer breadth of the charitable sector and the responsibilities of the IRS warrant some comment. There are approximately 1,300,000 charitable organizations in the United States, not counting religious organizations (churches, synagogues, and mosques). The level of charitable giving has been approximately $200 billion annually; and the 65,000 private foundations and corporate-giving programs contribute another $40 billion to charitable activities.[36] According to Independent Sector, there are 72,000 *new* nonprofits created annually.[37] The IRS, together with the state Attorneys General, has responsibility for the supervision of this sector.

The starting point for Commissioner Everson is the cost of the abuses in the charitable sector to the Federal Government annually – estimated to be approximately $15 billion. Commissioner Everson points to the inflated valuation that taxpayers claim for land, art works, and noncash items that they donate to charities.[38] Commissioner Everson also voiced concern over excessive compensation in the sector,[39] as well as certain abuses of conservation easements, of certain donor-advised funds, of certain Section 509(a)(3) supporting organizations, and the number of complaints received in 2004 regarding allegations of political activity by nonprofit organizations.

The Commissioner's roadmap should be read in full, along with the other roadmaps on the table.

D. Critical Commentary

One highly respected attorney practicing in the nonprofit sector commented upon the divergent approaches that appeared at the Senate hearing on April 5, 2005 and on the recommendations of Messrs. Hatch, Yin and Everson. He noted that "the ultimate legislative proposal emanating from this Committee may be far more draconian than previously thought."[40] Of special concern to him were (i) the proposals to remove the rebuttable presumption of reasonableness and (ii) the proposed limitations on travel and expenses to Federal employee levels. One practical piece of advice from that attorney was a recommendation that nonprofit healthcare entities begin to document their "community benefits," a recommendation that the author if this article has long advocated.[41]

III. THE NEW HAMPSHIRE INITIATIVE

Whatever recommendations, if any, may be adopted on the national level, New Hampshire has developed a strategy of its own for the nonprofit sector. In 2004, the New Hampshire Charitable Foundation and the New Hampshire Attorney General's Office jointly convened a committee to work standards for the sector. The "Excellence in Nonprofit Governance Committee" (the "Committee") is composed of 21 members and held a series of listening sessions around the state to discuss legal and ethical standards. At a February 2005 press conference with the Governor and Attorney General, the Committee announced an action plan with practical steps to guide New Hampshire nonprofit entities in concrete ways.[42]

The focus of the New Hampshire initiative was on achieving excellence, promoting education of nonprofit boards, and informing directors of their fundamental duties. The first step was publication of a short legal checklist setting forth in clear language New Hampshire's legal requirements for charitable entities.[43] This legal checklist is attached to the end of this article and is a useful tool for every charitable entity, no matter what the size. (See **Attachment A**)

The second step was the publication of a revised "Guidebook for Directors and Officers of Nonprofit Organizations," with sample forms and a question-and-answer section. The Guidebook provides statistical data on the number of charitable entities in New Hampshire (approximately 5,400 as of December 2004) and the estimated value of all charitable assets in New Hampshire (approximately $12.5 billion for 2003).[44]

The third step was a series of educational sessions to be held throughout the state on legal compliance issues for all charities, conducted by Terry Knowles, of the New Hampshire Attorney General's Office and the Center for Nonprofits.[45]

One of the intangible benefits of the Committee's work was the opportunity for the 21 members to discuss charitable regulation and the charitable sector in broad terms. The Committee contained many different perspectives and included representatives from the Legislature, the Attorney General's Office, large public charities, small private foundations, and a number of law firms, among others. The sessions were frank and constructive.[46]

The Committee provided a clear roadmap; and its educational classes should raise the level of compliance and understanding of key concepts – "fiduciary duties," "stewardship," and "internal controls." Since other states have developed strong programs, including certification programs, these state-based efforts may be as significant as national initiatives.[47] Indeed, similar state-based programs in Pennsylvania and Maryland have become models.

IV. OTHER INITIATIVES/OTHER EFFORTS

There are developments outside the Senate Committee hearings that are impacting the recommendations yet to be made. A brief discussion follows:

(a). NY University Law Center. The John D. and Catherine T. MacArthur Foundation and New York University Law Center convened a session of approximately 20 participants to discuss governance issues ("Best Practices after Sarbanes-Oxley") and to consider specific proposals for the sector. Professor Harvey Dale, Esquire, who heads the National Center on Philanthropy and the Law, chaired the session.[48]

The group included a cross-section of the sector: law professors from Yale and Stanford universities, attorneys who specialize in nonprofit work, state regulators, and presidents of foundations and nonprofit organizations, among others. Professor Harvey Dale is submitting a major paper on reform in the sector to the Nonprofit Panel discussed earlier; and the session was an opportunity for a frank discussion of the strengths and weaknesses of the sector.

The discussion examined a wide range of issues: (i) the lack of regulatory and enforcement resources at both the Federal and State levels, (ii) the diversity within the sector itself, (iii) the appropriateness of applying Sarbanes-Oxley to nonprofit entities, (iv) emerging standards of good governance in the sector, and (iv) the proliferation of charitable entities during the last two decades. A specific proposal for strengthening governance was discussed, where a governing board would consist of "governors" charged with fiduciary duties and "board members" who did not bear that responsibility.

The National Center on Philanthropy and the Law at New York University School of Law have become a fine resource for materials on all nonprofit issues.

(b). Academic Initiatives. Several interesting proposals for regulating the charitable sector have come from the academic world. Each proposal offers a unique perspective and takes the sector in very different directions. Joel L. Fleishman, for example, has called for the creation of a federal agency (much like the Securities and Exchange Commission) to deal with the nonprofit sector.[49] By contrast, Dana Brakman Reiser takes a very different approach, with suggestions on "contracting" for accountability and empowering ("signaling") intermediaries to assist the IRS and the state Attorneys General in their work.[50] Professor Reiser suggests that state Attorneys General contract with local nonprofits to train and educate nonprofit governing boards.

Both Fleischman and Reiser are searching for an approach that would resolve the problems presented by a diverse and proliferating sector; and their innovative thinking is very much appreciated within the sector.

Professor Michael Klausner and Jonathan A. Small offer still a third approach to the sector, as indicated above. Their proposal would create governing boards with different types of board members. They emphasize the importance of an independent, aggressive governing board to ensure compliance with ethical and legal matters.[51]

(c). Better Business Bureau and BoardSource. New Hampshire charities may want to consult other independent organizations that are working hard to promote good governance. Two organizations in particular demonstrate the work that is now being done within the sector itself: (i) the Better Business Bureau Wise Giving Alliance and (ii) Boardsource. Both have devised practical accountability tools and materials.

The BBBWise Giving Alliance has created a new Online Charity Evaluation and Reporting System at its website (www.give.org) that enables national charities, free of charge, to submit information via an online form that is programmed to help complete evaluative reports in relation to the Alliance's 20 *Standards for Charity Accountability*. These voluntary standards address governance as well as charity finances, fund raising, effectiveness and donor privacy issues. Although that evaluation tool is designed for national charities, it may be downloaded and considered by New Hampshire charities.

Other organizations in Maryland and Pennsylvania offer certification programs for charities and evaluation tools of their own.[52] For a governing board serious about governance, transparency, accountability and excellence, the tools are easily available at the websites listed in the endnotes. BoardSource, a major nonprofit whose mission is to educate governing boards, has created a list of the 10 basic responsibilities of governing boards. For New Hampshire attorneys and board members, this list is worth reviewing. It includes (i) selecting the chief executive, (ii) providing proper financial oversight, (iii) ensuring adequate resources, (iv) ensuring legal and ethical integrity, and (v) evaluating the performance of the chief executive, among others.[53]

CONCLUSION

For the first time in several decades, there has been a focused discussion at several levels within the charitable sector – in New York (at NYU), in Washington, D.C. (at the Senate hearings), in New Hampshire (with the Committee) and throughout the United States (with the Nonprofit Panel's meetings). There is a growing consensus that action must be taken in order to achieve excellence in governance; and several comprehensive roadmaps for improving the charitable sector have been crafted. Although the recommendations offer profoundly different paths, it is not possible at this point to determine which path or paths may be taken. Whether consensus can be reached – or whether this unique opportunity for reform passes without substantive action – remains to be seen.

In addition, work in New Hampshire has proceeded on a parallel path, with its own concrete action plan. New Hampshire attorneys should consult the recommendations being made and offer their own suggestions. We all have a stake in the outcome and differing voices need to be heard.

ATTACHMENT A:

NEW HAMPSHIRE NONPROFIT CHECKLIST

Legal Requirements for NH Nonprofit Organizations

(defined as all IRS 501(c)(3) entities, except religious organizations)

For All Nonprofits

Annually

- ❑ Filing of Annual Report with NH Director of Charitable Trusts*
- ❑ Filing of Form 990 with NH Director of Charitable Trusts and with the IRS*
  (If annual revenue is <u>under $25,000</u> a 990 is NOT required. Form NHCT–2A should be substituted.)
- ❑ Conflict of Interest Policy and filing of annual conflict of interest statement with the NH Director of Charitable Trusts

When nonprofit is established

- ❑ Registration with NH Secretary of State* (must be renewed every five years)
- ❑ Minimum of five independent directors (see RSA 292:6-a)
- ❑ IRS 501(c)(3) tax exempt status confirmed by IRS Exemption Letter
  Date of Determination ______________
- ❑ Employer Identification Number (EIN) received from IRS
  EIN ______________________________

*Some NH nonprofit organizations <u>are affiliates of regional or national organizations</u> and are not required to be registered with the State of NH, provided the national organization has registered. In such cases a letter of explanation should be supplied.

For Nonprofits with revenues over $500,000 - to be filed with the NH Director of Charitable Trusts

- ❑ Nonprofits with annual revenues of $500,000-$1,000,000 must file financial statements prepared in accordance with Generally Accepted Accounting Principals
- ❑ Nonprofits with annual revenues over $1,000,000 must file an audited financial statement
- ❑ Note: Nonprofits with endowment funds have additional requirements

(See reverse side for resources)

This organization (print name of org.)

____ is in compliance with all of the requirements of the NH Director of Charitable Trusts, the IRS and the NH Secretary of State, as listed above.

____

Board President/Chair - Print Name Executive Director/CEO - Print Name

____

Signature Date Signature Date

This form needs to be originally signed on an annual basis.
Photocopies of the original are perfectly acceptable.
DO NOT submit copies of all the documents listed here.

RESOURCES

The Director of Charitable Trusts has a very helpful website: www.doj.nh.gov/charitable.
And has also created a helpful guidebook.
This guidebook may be downloaded from the above website under publications.

References for requirements for all nonprofits

Copies of statutes and forms may be found at www.doj.nh.gov/charitable

- Registration with NH Director of Charitable Trusts - RSA 7:19 through 7:32-l
- Conflict of Interest Policy that complies with 1997 Statute - RSA 7:19-a
- Annual Report filed with Director of Charitable Trust - RSA 7:28

Copies of statutes and forms may be found at www.sos.nh.gov/corporate/forms

- Annual spending policy in compliance with Uniform Management of Institutional Funds Act - RSA 292-B
- Investment Policy that complies with Uniform Prudent Investor Act - RSA 564-B
- Uniform Trust Code - RSA 564-B

***Other useful websites*:**

www.state.nh.us – click on Laws and NH Statutes for full text of New Hampshire laws

www.guidestar.org – all IRS Form 990's in searchable format

www.irs.gov – additional information on Federal tax laws relating to charities

www.nhnonprofits.org – information on workshops, upcoming events, and other issues of interest to New Hampshire nonprofits

www.independentsector.org – a national coalition of leading nonprofits, foundations and corporations strengthening not-for-profit initiatives, philanthropy and citizen action

www.boardsource.org – a national organization dedicated to building effective nonprofit boards

ATTACHMENT B :

OFFICE OF THE NEW HAMPSHIRE ATTORNEY GENERAL
CHARITABLE TRUSTS UNIT
33 Capitol Street, Concord, NH 03301-6397

MUST BE COMPLETED
AND ATTACHED TO FILING

APPENDIX TO ANNUAL REPORT

Name of Organization:____

1. Is there currently a conflict of interest policy in effect? Yes______ No______

   A Conflict of Interest Policy is required by law (see RSA 7:19 II)

2. Did any officer, Director, Trustee or member of the immediate family obtain a pecuniary benefit from the organization in the last year other than reasonable compensation for services rendered and expenses incurred in connection with their official duties? Yes______ No______

If yes, complete the following:

A. Was any real estate transaction involved? Yes______ No______

B. Was a loan made to any director, officer or trustee? Yes______ No______

C. Was a pecuniary benefit paid in excess of $500? Yes______ No______

   If yes, attach copy of meeting minutes.

D. Was a pecuniary benefit paid in excess of $5,000? Yes______ No______

   If yes, attach a copy of:

- Public Notice
- Meeting Minutes
- Employment Contract

E. Provide a **list** of each pecuniary benefit transaction involving a director, officer, trustee or member of the immediate family. Include names of recipient(s) and amount(s) of benefit as required under RSA 7:28.

NOTE: The Director of Charitable Trusts may request **copies** of all contracts, payment records, vouchers and financial records or documents involving a director, officer, trustee or member of the immediate family as required under RSA 7:24.

ENDNOTES

1. This article represents the opinions and conclusions of its author and not necessarily those of the Attorney General. The material presented herein may not be understood to be an Opinion of the Attorney General, which are formal documents rendered pursuant to statutory authority, nor to express the views of the Attorney General.

2. See www.finance.senate.gov for the complete testimony and hearings. As this article was going to press, Senators Grassley and Baucus, the Chair and Ranking Member, respectively, of the Finance Committee, issued a letter to the Honorable John Snow, Secretary of the Treasury Department, expressing "continued concern" over Type III Supporting Organizations and the regulations issued by the Treasury Department. See, "Grassley, Baucus Plan to Take Aim at Abusive "Supporting Organizations" for Charities," dated April 25, 2005.

3. See the website for the Panel on the Nonprofit Sector,

www.nonprofitpanel.org. Contact information for the Panel is as follows: Panel on the Nonprofit Sector, 1200 Eighteenth Street, NW, Suite 200, Washington, D.C. 20036 (202-467-6120).

4. See the website for the New Hampshire Charitable Foundation for recent press releases and statements on the Excellence project – www.nhcf.org.

5. The author of this article was a participant in the sessions at NYU Law Center in February 2005. The author was also co-chair with Lew Feldstein, president of the New Hampshire Charitable Foundation, of the Excellence in Governance Project, which held its listening sessions in the fall of 2004.

6. See in particular, Reiser, Dana Brakman, "Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability," University of California Law School, Davis [ ]

7. For the "Boston Globe" series of articles on charitable abuses and excessive compensation, see in particular, "Some Officers of Charities Steer Assets to Selves," October 9, 2003; "Foundation Lawyers Enjoy Privileged Position," December 17, 2003; and Marion Fremont-Smith, "Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002," The Exempt Organization Tax Review, Vol. 42, no. 1, October 2003, pp 25-59.

8. The material in this section was taken from the "Boston Globe" article by Walter V. Robinson and Michael Rezendes, December 16, 2004, entitled "Foundation Chief Agrees to Repay over $4M: Papers Show Cabot Spend Funds on Self."

9. The 24-member Panel includes the Presidents and CEOs of the Ford Foundation, the American Red Cross, the United Way of America, the YMCA of the USA, the Rockefeller Brothers Fund, the W.K. Kellogg Foundation, the American Cancer Society, the United Nations Foundation, the American Heart Association, and the Evangelical Council for Financial Accountability, among others.

10. The Panel held sessions in 12 cities to solicit comments on the work of the panel and its recommendations. The sites of the sessions ranged from San Diego, California to New York City and included Denver, Colorado, Minneapolis, Minnesota, Dallas, Texas, and Detroit, Michigan, among others.

11. The author of this article attended one of the "field meetings" held by the Panel to discuss the Interim Report.

12. See, "Testimony by Diana Aviv, April 5, 2005," at www.independentsector.org and www.nonprofitpanel.org.

13. For the entire Interim Report and associated materials, see both www.independentsector.org and www.nonprofitpanel.org. The Independent Sector site, in particular, contains a wealth of information on issues such as codes of code and accountability issues.

14. Wolverton, Brad, "Nonprofit Abuses Will Be Examined at Senate Hearings," The Chronicle of Philanthropy, February 17, 2005 at www.philanthropy.com

15. Ibid. Also, see the Senate Finance Committee website at www.finance.senate.gov

16. See www.finance.senate.gov for the statements of Senator Grassley and Senator Backus made at the June 22, 2004 hearings in the Dirksen Senate Office Building. In addition, on that website, are the statements of Mark Everson, the Commissioner of Internal Revenue Service; William Josephson, former Bureau Chief of the Charities Division, New York Attorney General's Office, State of New York; Diana Aviv, President and CEO of Independent Sector; and Derek Bok, President Emeritus, Harvard University, among others. Senator Grassley stated that "The testimony we will hear will suggest that far too many charities have broken the understood covenant between the taxpayers and nonprofits – that charities are to benefit the public good, not fill the pockets of private individuals. Too many well-meaning charities have fallen prey to the charlatans' pitch about easy money. Some charities are blinded by their own mission and the need for additional dollars…It is the taxpayers who are the losers." Senator Backus made the following remarks: "But while many charities are focused on doing good works and preserving the public trust, there have been a number of high-profile examples of problems in this expanding sector: inflated salaries paid to trustees and charity executives; insider deals with insufficient transparency; charities engaging in abusive tax shelters, and charities serving as conduits to finance terrorist activities and operations. This proliferation of sloppy, unethical, and criminal behavior is unacceptable." The June 2004 Senate hearing led to the Panel on Nonprofits and the effort to have the charitable sector itself craft recommendations for the Senate Finance Committee to consider.

17. The impetus for self-scrutiny was the result of the dual shocks that the sector received from (i) the United States Senate Finance Committee ("Finance Committee") and (ii) the wave of abuses in the charitable sector reported by the media. For those interested in the crafting of public policy, the interplay between "external factors" (government pressure and media scrutiny) and reform efforts by the sector itself provides an excellent case study in how reform is achieved.

18. As of March 22, 2005, the charitable entities that have signed onto the Interim Report include the New Hampshire Charitable Foundation. In addition, approximately 60 other major charities or individuals have also endorsed the Interim Report, including the American Cancer Society, the American Heart Association, the American Red Cross, the Council on Foundations, the Michigan Nonprofit Association, the Minnesota Council of Nonprofits, the Pew Charitable Trusts, the Rockefeller Foundation, and the United Way of America.

19. See, DeLucia, Michael, "Sarbanes-Oxley and the Impact Upon New Hampshire Nonprofit Organizations," New Hampshire Bar Journal, Summer 2004, pp. 46-57.

20. Testimony of Diana Aviv on April 5, 2005, page 7.

21. New Hampshire RSA 7:19-a

22. New Hampshire RSA 292:6-a

23. The IRS will begin to phase-in mandatory electronic filing for larger charitable organizations in 2006.

24. RSA 7:28 III-a, III-b, III-c

25. See, the GAO Report to the Chairman and Ranking Minority Member, Committee on Finance, U.S. Senate, "Tax-Exempt Organizations: Improvements Possible in Public, IRS, and State Oversight of Charities," April 2002.

26. The prudent investor rule was originally contained in RSA 564-A. It has now been incorporated into the new Uniform Trust Code, RSA 564-B, effective in 2004.

27. See, editorial in USA Today, "As charitable cheating rises, so does cost to taxpayers," April 12, 2005, www.usatoday.com; Brad Wolverton, "Nonprofit Abuses Cost Federal Government Billions of Dollars, IRS Chief Tells Senators," Chronicle of Philanthropy, www.philanthropy.com; Stephanie Strom, "Official Cites Tax Abuses with Charities," New York Times, April 6, 2005, www.nytimes.com

28. The author of this article attended the public session organized by the Nonprofit Panel in Washington, D.C. on April 19, 2005, where those in attendance provided a very wide spectrum of comments – both supportive and critical - of the Interim Report. Ideas presented during the session included recommendations that religious organizations be required to file at least minimal information statements with the IRS, to trepidation over "performance measures" for nonprofits, to support for annual audited financial statements for larger charities, to concerns over board compensation other than "reasonable expenses," to the existence of excessive valuations of charitable donations, to fear of the sharing of confidential IRS tax information with state agencies, among many thoughts expressed.

29. See, www.nh.gov/nhdoj/charitable

30. The full comment by Eisenberg is that the Panel "produced a timid, uninspired report, long on mild, safe suggestions for changes in federal regulations and proposals for self-reform, but very short on tough measures needed to stop abuses and restore public confidence…The preliminary recommendations by Independent Sector are, unfortunately, grossly inadequate to meet the challenge of cleaning up nonprofit groups…For $3,000,000 it should be possible to produce more than a mouse of a report…The public deserves better." See, Pablo Eisenberg, "A Lukewarm Effort to Curb Abuses by Nonprofit Groups," in the Chronicle of Philanthropy, March 31, 2005, p. 59.

31. See the webpage for the Minnesota Attorney General's Office at www.ag.state.mn.us

32. AG Hatch testimony on April 5, 2005

33. See, in particular, Attorney Michael Peregrine's commentary dated April 6, 2005 (publications/newsletters) at www.mwe.com.

34. Specifically, the Commissioner stated the following: "From 1995 through

2003, there was an increase of over 40 percent in the number of exempt organization returns filed, yet IRS staffing of the exempt organizations function steadily declined." See, Everson testimony, page 2 at www.senate.finance.gov.(

35. See, Mary Grace Blasko, "Standing to Sue in the Charitable Sector," University of San Francisco Law Review (28 USFLR 37, Fall 1993).

36. See the Interim Report at www.nonprofitpanel.org.

37. See, April 12, 2005 data sheet from Independent Sector, handed out at the session held in Washington, D.C. on April 19.

38. See, Brad Wolverton supra; and Commissioner Everson's testimony on April 5, 2005.

39. The Commissioner's testimony stated that the IRS began in 2004 a "comprehensive enforcement project" and has contacted some 2,000 public charities and private foundations regarding their compensation practices and the independence of governing boards that approved the compensation.

40. See, Michael Peregrine, "Sweeping Legislative Changes for Nonprofits Move Closer to Reality," April 6, 2005, newsletters, www.mwe.com

41. New Hampshire adopted its community benefits statute in 1999 (RSA 7:32 et seq.,). There are approximately a dozen states that have implemented some type of common benefits reporting. The two most recent are Maryland and Illinois. See, "Advancing the State of the Art in Community Benefit: A User's Guide to Excellence and Accountability," Public Health Institute (November 2004, Berkeley, California).

42. Detailed information on the members of the Committee, the goals of the project and the Governor's Press Conference are found at the website for the New Hampshire Charitable Foundation, www.nhcf.org.

43. See the attachment at the end of the article for the check-list.

44. See the website for the Urban Institute's National Center for Charitable Statistics, www.urbaninstitute.org

45. The educational sessions are a collaboration between the Center for New Hampshire Nonprofits and the Attorney General's Office.

46. For a list of the members, see www.nhcf.org and the "Union Leader," February 24, 2005, page A-2.

47. One example of a strong state-based program is the Pennsylvania Association of Nonprofits. Materials and evaluation tools may be found at its website, www.pano.org.

48. Professor Dale was retained by Independent Sector to provide a working paper on governance for the Panel on the Nonprofit Sector to consider.

49. Fleishman, Joel L., "Public Trust in the Not-for-Profit Organizations and the Need for Regulatory Reform" in

Philanthropy and the Nonprofit Sector in a Changing America (C.T. Clotfelter & T. Erlich, editors, 1999), pp 188-191.

50. Reiser, Dana Brakman, "Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability?", 38 U.C. Davis L. Rev. 205 (2004).

51. Michael Klausner is a professor at Stanford University Law School, Stanford, California; and Jonathan Small, Esquire is President of the Nonprofit Coordinating Committee of New York.

52. For the Pennsylvania Nonprofit Association's materials, see www.pano.org, where it has a "proactive accountability" section and standards for excellence. For the certification program of the Maryland Association of Nonprofit Organizations, see www.marylandnonprofits.org.

53. See, BoardSource (formerly the National Center for Nonprofit Boards), with headquarters in Washington, D.C. The website is www.boardsource.org; the contact information is 800-883-6262.

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